

Energy Subsidy and Economic Production: The Evidence from Malaysia and Indonesia

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Abstract

Energy subsidy policy is one of the most favorable policies implemented by many oil producer countries in improving their economic development. However, the economic outcome is still debatable due to the implications on economic efficiency, fiscal policy and et cetera. As two main oil producer countries in ASEAN 5, both Malaysia and Indonesia had allocated 5% of energy subsidy (% of GDP) averagely throughout the period of 1990-2014. This paper is intended to study the impact of energy subsidy on economic production in Malaysia and Indonesia by employing a dynamic panel data analysis. Our finding suggests that the energy subsidy affects the growth output positively in the long run. We conclude that energy subsidy is significant to promote economic growth in both countries. The absence of energy subsidy will bring harm to the economic growth. However, if a reduction of energy subsidy is essential to improve efficiency and fiscal pressure, we suggest the policymaker to implement some offsetting policies to cushion the economy from any shocks.

Keywords: Energy; subsidy; output; panel data analysis

1. Introduction

Malaysia and Indonesia are the net oil exporting countries in ASEAN 5. Accumulatively, they have recorded -117 average value of net energy import throughout 2010-2013. As part of the oil production countries in the world, Malaysia and Indonesia earned averagely 5.8% and 2.4% of oil rent (% of GDP) throughout 2010-2014. Tellingly, their revenue was contributed much by oil production. With the combination of GDP, they have contributed about 52% share of GDP in ASEAN 5 economies for the year 2014. In addition, both Malaysia and Indonesia have achieved the highest economic growth in ASEAN 5 economies which is about 6% and 5% in the year 2014, respectively. Malaysia and Indonesia have allocated a huge amount of subsidy, about 74% share of total subsidies in ASEAN 5 economies were contributed by Malaysia and Indonesia in 2014. Out of this value, 74% were allocated for energy subsidy². In general, as the oil producer countries in the world, it gives them many advantages to invest much on energy subsidy to drive a good performance of their macroeconomics and to increase the economic welfare.

There are many arguments on the role of subsidy in promoting economic growth recently. In one side, it is believed that the subsidy can give a cost advantage to the producer and increase the economic welfare of a society in the market (Van Beers and Van den Bergh, 2001). Consequently, it forms a conducive economic environment to promote a rapid national growth. On the other side, the subsidy program is believed not to form a conducive economic environment derived from the existence of the death weight loss in the market and fiscal pressure problem. Thus, it brings to a situation of where the economic system is unproductive to encourage a rapid national growth (Isaak, 2015; Arzedel Granado et al, 2012). In respect to

² All numbers and percentage quoted are retrieved from World Bank Development Indicator (WDI), Bank Negara Malaysia and *Bank Sentral Republik Indonesia*.